

# **BLUEPRINT FOR THE FUTURE PLAN**

## **PROPOSED COST RECOVERY**

## **A. BSA Mechanism**

The Company has proposed a Bill Stabilization Adjustment (“BSA”), a billing adjustment to be applied on a quarterly basis for all customers. The initial and most visible benefit of the BSA is to reduce the volatility in the distribution charge on customer bills. In severe weather in which customers face sharply higher bills, the BSA will reduce the payments that would otherwise be due. Conversely under the BSA, customers will pay more for delivery in mild weather than they would otherwise, but their overall bills will still be down compared to what they would be with normal weather. In short, customers’ bill variability is somewhat decreased.

The BSA is intended to stabilize revenue fluctuations resulting from unanticipated changes in usage, and ensures that the Company only recovers the Commission approved level of distribution costs. In essence, the BSA provides for decreases in delivery rates if actual revenues per customer are above the Commission approved level, and it provides for increases in delivery rates if actual revenues per customer are below the Commission approved level.

The BSA, as proposed by the Company, creates an adjustment to customers’ bills that is designed to reflect differences between Commission-approved delivery revenue levels and actual delivery revenues. This is good for the customer because the Company’s customers will pay only the amount determined by the Commission as required to provide safe and reliable service. This is a benefit to the Company because the Company can maintain a stable revenue stream year-to-year. The BSA provides the Company with a stream of revenues consistent with the costs of providing safe and reliable service. The Company’s costs for providing service are generally fixed, regardless of the volume of sales that the Company delivers to its customers. This proposal provides for a matching of revenues in quarterly periods, with the corresponding amounts that the Commission has approved as adequate compensation for providing service. Thus, both customers and the Company are better off under the mechanism. The mechanism also protects the Company from ongoing attrition due to the reduced usage of customers. This will help avoid frequent rate cases and the attendant costs.

The BSA will promote demand side management measures. In this filing, the Company is proposing development of electric energy efficiency measures and demand response services for residential and small commercial customers, as part of an overall response to the recent increases in supply prices. Demand side management programs reduce sales and, consequently, revenues and fixed cost recovery decline. This creates a disincentive for the utility to consider demand side resources. The existing rate structure provides strong incentives for utilities to sell as much electricity as possible in order to maximize profit. The BSA removes the incentive for the Company to maximize its sales in order to benefit shareholders. Without the BSA, the Company’s shareholders benefit with each additional kWh delivered. With the BSA, the link between increased sales and profits is broken. The Company’s interest in helping its customers use energy wisely and efficiently is no longer at seeming odds with the interests of shareholders. By decoupling the Company’s revenues from changes in the volume of electricity delivered to customers, the adoption of the BSA aligns the Company’s interests with the interests of the customer. The adoption of the BSA mechanism is a critical component of the Company’s

overall proposal to institute conservation programs to help customers meet the challenges of the current high costs of energy, without conflicting with the interests of shareholders.

The issues described above are not unique to Delmarva; many other utilities across the country, both gas and electric, are in a similar position, and have developed a variety of approaches to address the over-recovery and under-recovery issue and the disincentive towards demand side resources. The issue of the mis-match between the structure of costs and rates has long been faced by gas distribution utilities, since gas unbundling preceded electric unbundling. Hence, many gas distribution utilities have implemented these mechanisms. Broadly speaking, the approaches can be categorized as follows:

- Weather Normalization Clauses – riders that correct for weather related changes in usage;
- Revenue Decoupling Tariffs – riders that correct for any differences in the usage levels built into base rates;
- Return Stabilization Mechanisms – expedited rate proceedings or riders that correct for both differences in usage and differences in cost;
- Fixed Variable Rate Design – changes in base rates that shift all fixed costs into fixed rate elements; and,
- Increased Customer Charge – shift additional fixed costs in the customer charge.

While different approaches to address this issue have strengths and weaknesses, the Company's proposal is particularly appropriate. In principle, rate structure changes that collect all of the fixed costs in a fixed charge would provide for the best alignment of costs and rates. That approach would, however, significantly increase rates for small usage customers. Stabilizing the return also addresses the problem, but removes the incentive for a utility to manage costs. The BSA approach represents an appropriate balance between the objectives of cost alignment, gradualism and efficiency.

It is important to keep in mind that the BSA would only be applicable to the distribution portion of the customer's bill; currently, the distribution portion accounts for only 22% of the average residential customer bill. The supply portion of the bill, which accounts for almost 78%, would not be subject to the BSA. This has several important ramifications. First, customers still have a strong incentive to use energy efficiently, based on the savings associated with the supply side of the bill. Second, by being applicable to only the distribution portion of the bill, the BSA should create minimal fluctuation in the total amount of a customer's bill.

When implemented the Company's BSA proposal is expected to have the following impact: 1) Customer bills will be more stable; 2) Revenues will be better aligned with costs; 3) Disincentives toward energy efficiency will be reduced; and, 4) The Company will be better able to recover its fixed costs.

BSA is a billing adjustment to be applied on a quarterly basis to the distribution charge for customers in Service Classifications R, R-TOU-ND, SGS-ND, GS-SH, GS-WH, MGS, LGS and GS-P. The adjustment will not be applicable to lighting service classifications OL or ORL, due to the relatively constant level of usage for these classes. In addition, BSA it will not be applicable to service classifications R-TOU, R-TOU-SOP and GS-T due to the relatively small number of customers in those classifications. Excluding these service classifications from the BSA prevents the potential for a large usage swing of a single customer being unduly absorbed by the small number of remaining customers. The adjustment is intended to stabilize revenue based on the test year revenue per customer resulting from the base rates approved in this proceeding.

The BSA will be calculated on a quarterly basis and will be developed separately for each of the service classifications identified above. For each quarter, the approved test year revenue per customer for each service classification is applied to the actual number of customers in the billing quarter to arrive at target revenue for each service classification. The difference between the total quarterly target revenue and the actual quarterly revenue forms the basis for the BSA for the given quarter. To avoid unduly large swings in the BSA from quarter to quarter, the Company proposes to cap the level of the BSA charge or credit at 10% of the test year average rate for the applicable quarter for each rate class. This capping mechanism will result in a level of charge or credit which will be carried over into a subsequent quarter's adjustment. This amount is added to the revenue difference. In addition to the carryover due to the capping mechanism, an adjustment will be necessary each quarter to true up for over or under collections in the BSA in prior quarters. The over/under balances will also be added to the revenue differences to arrive at a final BSA revenue target for each rate class for the current billing quarter. The revenue is divided by projected sales for the upcoming quarterly bill period. As noted previously, this rate will be compared to 10% of the rate class test year average quarterly rate to determine the final BSA for the quarter.

Schedule BSA-1 provides a series of work papers providing an illustrative example of the BSA calculation, using test year data from the Company's recent Distribution Case (Docket No. 05-304) and currently approved distribution rates. For an indication of how the proposed DSM programs would impact the BSA mechanism, the example uses actual sales and customer data from the most recently available 12 month period, adjusted to take into account the estimated total energy reduction associated with proposed residential DSM programs. This approach provides an indication of the impact on revenues associated with the BSA mechanism.

Schedule BSA-2 shows the impact of the BSA on the monthly bill of a residential non-space heating customer who can take advantage of the estimated energy savings associated with the variety of the proposed DSM programs. The results show that, to an individual customer, the impact of the BSA mechanism is relatively minor when compared to the total bill savings associated with reduced energy consumption. In the example shown, for a customer who participates in all the DSM programs, the annual BSA would total approximately \$1.25 ~~6~~, while energy savings would amount to almost \$472. Obviously, these levels will vary based on individual customer use and overall level of program participation; however, they are indicative of the relatively small bill impact resulting from the BSA.

In summary, as outlined in this filing, the BSA mechanism proposed by the Company addresses the following issues and includes the following features:

- It addresses the issue of recovering essentially fixed costs via a rate structure which is dependent on volumetric components. It also places the Company in an economic and financial position to be a stakeholder in the promotion of energy efficiency measures.
- It provides customers with reasonably stable bills over the course of a year. The mechanism appropriately considers each service classification on an individual basis. Additionally, an effort has been made to identify and exclude rate classes which, due to size or usage characteristics, may not benefit from the BSA.
- The mechanism is understandable and verifiable based on available accounting data.
- By calculating the adjustment on a quarterly basis, the adjustment is timely, but also includes the benefit of tempering volatility associated with monthly usage variations. In addition, even though the mechanism is applicable to a relatively small portion of a customer's bill, it includes a cap to further prevent the potential for rate shock.

Tariff Sheets filed with this proceeding contain a new Rider pertaining to the BSA.

**BILL STABILIZATION ADJUSTMENT  
PROPOSED TARIFF SHEET**

Delmarva Power & Light Company

P.S.C. Del. No. 8 - Electric  
Second Revised Leaf No. 105

RIDER "BSA"

BILL STABILIZATION ADJUSTMENT

A. Bill Stabilization Adjustment

The Distribution Charges billed under the Company's Service Classifications R, R-TOU-ND, SGS-ND, MGS-S, GS-SH, GS-WH, LGS and GS-P shall be subject to a Bill Stabilization Adjustment (BSA). The BSA shall be computed quarterly for application in the second succeeding billing quarter. It shall consist of a factor designed to reflect differences between test year and actual base rate revenues, plus a factor designed to reconcile prior period Bill Stabilization Adjustments with actual billed BSA adjustments. The BSA charge or credit shall be applied to monthly bills beginning with the billing month of XXX, 2007.

B. Calculation of BSA

- (1) The BSA shall be computed by dividing the difference between the actual quarterly revenue and the test year revenue, plus any applicable trueup amount from previous quarters, by the forecast billing units (kWh or kW) applicable to the service classification for the second succeeding quarter. The test year revenue is defined as quarterly sum of the product of the average revenue per customer for the each billing month in the current quarter at rates approved in the latest base rate proceeding and the number of customers for each corresponding billing month in the current quarter.

- (2) Formulaically:

$$BSA = \frac{A - \sum_m (B_m * C_m) + D}{E}$$

Where:

BSA = the quarterly Bill Stabilization Adjustment factor for the class in \$

per kWh or kW

A = Quarterly Distribution Revenue in \$ (actual revenue for Months 1 and 2 of each quarter, budget revenue for Month 3, subject to reconciliation in succeeding quarter)

B = Average Distribution revenue per customer for the corresponding month in the test period

C = Class customer count for the corresponding month in the current billing quarter

D = cumulative true-up for over/under-collections in previous quarters in \$

E = Service Classification Billing Unit (kWh or kW) for the succeeding quarter

- (3) The amount of the adjustment factor for any rate schedule may not exceed +/- 10% of the average test year rate per kWh or per kW, for the associated Service Classification. Any excess amount above the cap shall be collected in a subsequent quarter.

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Filed

Effective

RIDER BSA

BILL STABILIZATION ADJUSTMENT (continued)

C. FILING

The Company shall file quarterly with the Commission a copy of the computation of the BSA current factors and/or reconciliation factors at least ten days prior to application on customers' bills. The Company shall furnish Commission Staff sufficient workpapers for the review and audit of the BSA.

Filed

Effective

**SAMPLE BSA CALCULATION  
EXCEL SPREADSHEET**

**SAMPLE BSA CALCULATION  
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